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DEPARTMENT FOR EEB/CBA AND EUR/NB

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TAGS: PGOV EFIN ECON EINV EN
SUBJECT: Estonian Banks and Markets: Whistling Past the Graveyard ... for now

¶1. (U) SUMMARY: The Government of Estonia (GOE) is moving quickly to reassure the public and raise deposit guarantees as the global financial crisis continues to dominate the news. On October 9, the GOE approved a new EUR 50,000 limit on deposits. Local bankers and stock market officials remain cautiously, if nervously optimistic that Estonia's Swedish- and Finnish-owned banks are stable, relatively safe from recent European and U.S. collapses, and that the public, for now, will not panic. END SUMMARY.

Estonian Economy Afloat, but Feeling the Global Crunch

¶2. (U) Estonia is already feeling some ripple effects from the spreading global credit crisis. Typically insulated in the Nordic/Baltic tributary of global capital flows, the country has been exposed to growing investor fears throughout Scandinavia and Europe. The 8 percent average GDP growth rate Estonia enjoyed since 2000 was driven largely by the real estate sector, a bubble that has now burst. The outlook for 2008 is for inflation of 10 percent and GDP growth just over 1 percent. In early October, Fitch Ratings downgraded Estonian default ratings from A to A-, and has long expressed concern over the three Baltic countries' current account deficits, rapid credit growth and rising debt ratios.

¶3. (U) The Lehman Brothers collapse did impact the Estonian market, shattering the illusion that Estonia is shielded from the U.S. markets by Scandinavia. Lehman's London branch had pumped EUR 79 million into Tallinn's real estate market in early 2008, and its bankruptcy has left a major shopping center development in mortgage limbo. Estonia's Unemployment Insurance Fund (UIF) is managed by Fortis Investments Management, but since the Belgian company's takeover, a financial advisor to the UIF has said Estonia's state assets are not in danger. They are deposited with the Swedish-owned SEB bank in Estonia, and simply managed by Fortis, but do not appear on the troubled company's balance sheet.

Government Moving Quickly to Reassure Public

¶4. (U) On September 30, Bank of Estonia Vice President Andres Sutt told us that Estonian banks are coping with the global financial turmoil. Capital and liquidity are strong, and recently tightened requirements now ensure greater safety and reliability in the banking system. On October 7, Minister of Finance Ivari Padar announced that Estonia will adopt the new EU regulations raising deposit guarantees to EUR 50,000, and by October 9, the Government of Estonia (GOE) had approved the measure, including 100 percent (up from the previous 90 percent) of deposits under EUR 50,000. The institution responsible for this is the Guarantee Fund (www.tf.ee) which has assets equal to three percent of

all deposits at financial institutions in Estonia. (NOTE: Estonian banks hold roughly USD 4.6 billion in excess of the old guaranteed minimum of EUR 20,000. END NOTE.) On October 8, a Ministry of Finance spokesperson told us they do not see any troubling signs of stress in the Estonian banking sector at the moment. Estonia's Financial Supervisory Authority (FSA) has checked on the solvency of local banks and feels they are stable and not at risk from 'toxic mortgages' or the like.

What the Bankers and Brokers Say:

¶5. (U) Central bankers and executives at the large private banks stress the basic stability of the system here, noting that even if parent companies in Sweden took a big hit, daughter banks in Estonia which are subsidiaries, not branches, would be somewhat insulated. The Estonian banking market is dominated by two Swedish banks, Swedbank (formerly Hansapank) and SEB who have jointly more than 76 percent of the market share. Following the Lehman Brothers collapse, Erkki Raasuke, CEO of Swedbank Baltic, and Vahur Kraft, CEO of Nordea Bank Estonia both stated that they felt the subsidiaries of Nordic banks in Estonia are safe.

¶6. (U) Erki Kert, head of analysis department of the Tallinn-based investment bank LHV, predicts that the U.S. crisis will certainly slow the recovery of the Baltic economies. (NOTE: In 2007, LHV employed 40 people across Estonia, Latvia and Lithuania, with net corporate profit of USD 1.7 million. END NOTE.) American Chamber of Commerce President Yrjo Ojassar estimates it will be several months before the full

impact of the U.S. crisis is felt in Estonia. However, he also told us he believes that ultimately the crisis could be a good thing for the economy, spurring greater innovation in companies that have heretofore been content to idly rake in profits in good times.

¶7. (U) The Tallinn stock market, the OMXT (which merged with NASDAQ in April 2008) has 18 listed companies. Since September 1, the index has fallen 31 percent. Market OMXT Managing Director Kalle Viks told EconOff this plunge is due to general investor fears stemming from the current global situation, rather than any specific local concerns about the Estonian economy. He does not expect any panic, or bank runs, and said that local banks are 'slightly worried', but customers are servicing their loans. Through the end of August, only 2 percent of outstanding commercial loans were overdue more than 60 days. However, the reporting service CreditInfo announced in mid-September that the year-on-year number of companies defaulting on payments rose 42 percent, to 3,163 for the first half of 2008.

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